8. Financial Planning for Transit

8.1 Introduction

Constructing transportation facilities, purchasing transit vehicles, providing new transit services, or merely maintaining existing services requires a significant financial commitment. Transit capital investments can last a generation or more and require consistent maintenance and reinvestment as well as continual operating subsidies. Prudent management requires that the decision to build new transit facilities, procure equipment, or make operating changes be supported by sound financial planning. Financial planning is the framework for evaluating the feasibility of any proposed transit improvement in the context of operating and maintaining existing levels of service.

Congress affirms the importance of sound financial planning through legislation that governs the federal transit program. Section 3(a)(2)(a) of the Federal Transit Act states that "No grant or loan shall be provided under this section unless the Secretary determines that the applicant has or will have the legal, financial, and technical capacity to carry out the proposed project". Section 5309(e)(4) of The Transportation Equity Act for the 21st Century (TEA-21) states that the Federal Transit Administration (FTA) must evaluate proposed major capital investments to ensure that they are supported by an acceptable degree of local financial commitment.

Responding to this legislation, FTA has been helping transit agencies improve their financial planning for many years. Most recently, FTA published the *Guidance for Transit Financial Plans (2000)*, which defines the content, scope and format of a solid financial plan. The intent of that guidance was to explain what a financial plan is. The intent of this *Section* is to provide a "how to" manual on financial planning methods. This *Section* serves to update the previous *Financial Planning Guide for Transit (1990)* in the context of recent legislative initiatives and planning practice. This section on financial planning focuses specifically on the development and use of financial planning models for ongoing transit capital and service planning.

8.1.1 The Role of the Financial Plan

A solid financial plan facilitates the selection and implementation of new services and projects and the ongoing operation and maintenance of the transit system. The financial plan presents the recent financial history of the transit agency, describes its current financial health, documents projected costs and revenues into the future, and demonstrates the reasonableness of key assumptions underlying these projections. The information in the financial plan helps decision-makers choose the best transit investments from the available alternatives.

The basic structure of the financial plan is consistent throughout the planning and development process. However, several key components become more detailed and the confidence in many estimates and forecasts increases as the project advances through the planning and development process. For example, project cost estimates become more reliable as the project scope is defined in detail and engineering studies are completed. Similarly, funding strategies become more certain as funds are committed. The financial plan is prepared during alternatives analysis and updated during preliminary engineering (PE), final design, and construction, as changes occur to project costs, funding, or external factors that affect agency finances.

While financial planning is a necessity for planning major capital investments, it is also a valuable tool for planning the most basic transit operations. Transit agencies that apply "best practice" planning methods will incorporate continuously updated financial models to help them plan ongoing services, vehicle replacements, maintenance and rehabilitation programs, capital investments, and to plan the funding and financing strategies that are the key to implementing the transit agency's activities. A financial planning model can help ensure the stability of transit agency operations by providing advance warning about potential financial difficulties and can help the agency develop and test realistic strategies to avoid those difficulties.

8.1.2 Organization of this Section

This *Section on Financial Planning for Transit* is designed to go beyond FTA's previous guides to provide a primer on "best practice" methods for developing key financial planning components. Previous guidance has emphasized the role of financial planning in the development and implementation of major transit investments. While this function is still vital, FTA now emphasizes the ongoing use of the financial planning model to inform every aspect of transit agency planning. As such, financial planning for project development is a straightforward extension of the everyday financial planning activities of the transit agency.

The contents of this *Section* follow the basic components of the financial planning model culminating in the use of the financial model for financial analysis in support of transit agency planning. The sections are:

8.2 Contents of a Financial Plan – This chapter specifies the components necessary for a solid transit agency financial plan. The chapter describes how each component of the plan is integrated into detailed capital and operating plans and how these plans combine into an agency cash flow projection. The chapter includes numerous examples to demonstrate the level of detail and format of a "best practice" financial plan and describes in detail, the supporting documentation required to substantiate the financial plan components. The remaining chapters detail the methods used to develop each plan component.

8.3 Capital Cost Estimates – This discusses the use of capital cost estimates in the financial planning process. The chapter offers some guidelines to reduce the risk of cost overruns and the methods for accounting for the uncertainty inherent in any cost estimate.

8.4 Operating and Maintenance Cost Estimates – This section includes a detailed discussion on the development of operating and maintenance cost estimates for proposed projects and existing systems.

8.5 Forecasting Revenue – This section describes the methods used to forecast transit system revenues for the existing system and incremental revenues from proposed projects. Also covered are "best practice" methods for forecasting tax revenues and user fees and the planning assumptions necessary to predict intergovernmental grants, subsidies and formula allocations.

8.6 Financial Analysis – This section describes how transit planners bring together all key financial planning inputs into an integrated financial model. Included in this chapter are discussions of the process of projecting capital funding requirements, operating subsidy requirements, managing debt levels, and performing sensitivity analyses. This chapter presents traditional methods of evaluating financial success and the use of the financial planning model to support the ongoing success of the transit agency.

Technical Addendum: Principles and Best Practices for Regression Analysis